

Number: **200728041**
Release Date: 7/13/2007

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 2642.00-00, 2654.00-00,
9100.00-00

Person To Contact: _____, ID No. _____

Telephone Number:

In Re:

Refer Reply To:
CC:PSI:B04
PLR-163959-05

Date:
March 22, 2007

Legend:

Trustee =
Trust B =

Trust C =
Family Trust =

State	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Year S	=
Husband	=
Wife	=
Trustors	=
Firm	=
CPA 1	=
CPA 2	=
\$K	=
\$N	=
\$L	=
\$S	=
Attorney	=

Court =

Dear :

This is in response to your authorized representative's submission dated December 9, 2005, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever certain trusts, make a reverse qualified terminable interest property (QTIP) election under § 2652(a)(3) of the Internal Revenue Code, and allocate Generation-skipping Transfer (GST) exemption pursuant to § 2642(g).

On Date 1, Husband and Wife established Family Trust, a revocable trust pursuant to State law. Husband died on Date 2, survived by Wife, five living children and numerous grandchildren. Wife died on Date 3.

Section 3.01 of Family Trust provides that on the death of either Trustor leaving the other Trustor surviving, the Trustee is to divide the entire Family Trust into three separate trusts: Trust A, to be funded with the surviving Trustor's share of the couple's community property; Trust B, a trust intended to qualify for the estate tax marital deduction under section 2056(b)(7); and Trust C, a credit shelter trust.

Section 3.03 provides that Trust B is to be funded with a pecuniary amount equal to the maximum marital deduction allowable for determining the federal estate tax payable because of the death of the deceased spouse, reduced by the final estate tax values of all property interests that qualify for the marital deduction and that pass or have passed to or in trust for the surviving spouse, and further reduced by the amount needed to increase the taxable estate of the deceased Trustor to the largest amount which will result in no federal estate tax being imposed in the estate of the deceased Trustor.

Under section 3.06(a), the trustee is to pay the surviving Trustor the entire net income of Trust B for and during the surviving Trustor's lifetime. On the death of the surviving Trustor, Trustee is to distribute the balance of any and all principal contained in Trust B to Trust C.

Section 3.07 provides that the surviving Trustor is to receive all of the income of Trust C and may, to the extent that other payments under Trust C are insufficient to provide for the care, maintenance, or support of the surviving Trustor, as determined by Trustee, invade up to five (5%) of the initial principal balance of Trust C. Under section 4.03(f), all of the assets of Trust C remaining in the possession of Trustee upon the death of the surviving trustor are to be distributed to Trustor's grandchildren in equal shares, by right or representation.

As noted, Husband died on Date 2. It is represented that Wife, serving as Trustee of Trusts B and C after Husband's death, retained the services of CPA 1 and CPA 2 at Firm, located in State, to advise her on trust administration and to prepare Husband's Form 706, United States Estate (and Generation-skipping transfer) Tax return. CPA 2 or others at Firm obtained an extension of time for filing Husband's estate tax return and prepared the Form 706 for filing.

On Schedule M of the Form 706, an election was made under § 2056(b)(7) to treat Trust B as "qualified terminable interest property" (QTIP), and an estate tax marital deduction in the amount of \$K was claimed. A Schedule R was not included with the Form 706 and consequently, a reverse QTIP election was not made under § 2652(a)(3). None of Husband's remaining GST exemption was allocated on Form 706. However, \$N of GST exemption was automatically allocated to Trust C under § 2632(c)(1) as in effect on Date 2.

Wife died on Date 3. At that time, the estate retained the services of CPA 1 and Firm to prepare the Form 706 for Wife's estate. It is represented that Wife's estate tax return was filed on Date 4. The estate tax return included a Schedule R allocating a total of \$L of Wife's GST exemption to testamentary transfers made by Wife. Line 8 of Schedule R indicates that \$S of Wife's GST exemption remained unallocated. The Trust B transfers to Husband and Wife's grandchildren were not reported on the Form 706, and no exemption was allocated with respect to these transfers.

The Trustee of Trust B contacted Attorney for advice regarding potential GST tax liability. Attorney petitioned Court requesting the division and modification of Family Trust. On Date 5, Court issued its order, dividing Trust B, effective as of Date 2, the date of Husband's death, into the Husband Exempt Marital Deduction Trust and the Husband Non-Exempt Marital Deduction Trust. The Husband Exempt Marital Deduction Trust is to be fully exempt from GST tax and is to have an inclusion ratio of zero after allocation of Husband's GST exemption remaining unused after the automatic allocation of exemption under § 2632(c)(1). The Non-Exempt Marital Deduction Trust is to be funded with the balance of Trust B. The terms of both trusts are identical to the terms, powers, and beneficiaries of Trust B as of the date of Husband's death.

The Court's Order further instructs the Trustee to divide the Husband Non-Exempt Marital Deduction Trust into two irrevocable trusts, effective as of Date 3, the date of Wife's death. One trust, the Second Husband Exempt Marital Deduction Trust B, is intended to have an inclusion ratio of zero after allocation of Wife's unused GST exemption. The other trust, the Second Husband Non-Exempt Marital Deduction Trust B, would be fully subject to GST Tax.

The Order directs the Trustee to pay first from the principal of the portions of Trust B that are not exempt from GST tax, any inheritance, estate or death taxes due to

the inclusion of Trust B in Wife's estate, as well as any reasonable attorney and accountant fees incurred in the administration of Trust B.

Trustee requests extensions of time under § 301.9100-3, as follows:

1. To sever Trust B, effective as of Date 2 (Husband's date of death) pursuant to § 26.2654-1(b), into Husband Exempt Marital Deduction Trust and Husband Non-exempt Marital Deduction Trust;

2. To make a reverse QTIP election, effective as of Date 2, under § 2652(a)(3) with respect to the Husband Exempt Marital Deduction Trust;

3. To allocate Husband's remaining GST exemption under § 2642(g) to the Husband Exempt Marital Deduction Trust;

4. To sever, effective as of Date 3 (Wife's date of death), Husband Non-Exempt Marital Deduction Trust into the Second Husband Exempt Marital Deduction Trust and Second Husband Non-Exempt Marital Deduction Trust; and

5. To allocate Wife's remaining GST exemption under § 2642(g) to the Second Husband Exempt Marital Deduction Trust.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Under § 2056(b)(1), no deduction is allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Under § 2056(b)(7)(A), "qualified terminable interest property" is treated as passing to the surviving spouse for purposes of § 2056(a) and no part of the property is treated as passing to any person other than the surviving spouse. Qualified terminable interest property is defined under § 2056(b)(7)(B)(i) as property: (1) which passes from the decedent to the surviving spouse; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under § 2056(b)(7)(B)(v) applies. Under § 2044, property subject to a QTIP election for which a deduction is allowed under § 2056(b)(7), is includible in the surviving spouse's gross estate on that spouse's subsequent death.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made by a transferor to a skip person. A GST is defined under section 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term “applicable rate” means with respect to any GST transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the “applicable fraction”. The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred to the trust or involved in the direct skip.

Under § 2631(a) as in effect during the years involved in this case, for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)) that may be allocated by the individual (or his executor) to any property with respect to which the individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, is irrevocable.

Section 2632(a)(1) provides that an individual's GST exemption may be allocated at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such return is required to be filed.

Under § 26.2632-1(d)(1), an allocation of a decedent's available GST exemption by the executor of the decedent's estate is made on Form 706 filed on or before the date prescribed for filing the return by § 6075(a) (including any extensions granted). An allocation of GST exemption with respect to property included in the gross estate of a decedent is effective as of the date of death.

Under § 2632(e)(1) and § 26.2632-1(d)(2), a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. The unused exemption is allocated: (A) first, to property which is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts, with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death. However, no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the new trust.

Section 2642(b)(2) provides generally that if property is transferred as a result of the death of the transferor, the value of the property for purposes of determining the

inclusion ratio under § 2642(a)(1) shall be the value of the property as finally determined for estate tax purposes.

Section 2642(g)(1)(A) provides, generally, that the Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption described in § 2642(b)(1) or (2), and an election under § 2632(b)(3) or (c)(5). Section 2642(g)(1)(B) provides that in determining whether to grant relief, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

Under § 2652(a)(1) and § 26.2652-1(a)(1), the “transferor” of the property for GST tax purposes is the individual with respect to whom the property was last subject to federal estate or gift tax. However, under section 2652(a)(3), in the case of a trust for which a deduction was allowed under § 2056(b)(7), the decedent’s estate may elect to treat all of the property in the trust as if the § 2056(b)(7) election had not been made for purposes of the GST tax (i.e., a “reverse QTIP election”). Accordingly, the decedent, and not the surviving spouse, is treated as the transferor of the property for GST tax purposes. The reverse QTIP election is irrevocable and is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies. Under § 26.2652-2(b), the reverse QTIP election is made on the return of tax on which the QTIP election is made.

Under § 26.2654-1(b)(1), the severance of a trust that is included in the transferor’s gross estate (or created under the transferor’s will) into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or local law; and

(A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust;

(B) The severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the Federal estate tax return (including extensions actually granted) for the estate of the transferor; and

(C) The new trusts are severed on a fractional basis. If severed on a fractional basis the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trust may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding.

Section 26.2654-1(b)(1)(ii)(C)(3) provides that an individual's GST exemption under section 2632 may be allocated to the separate trusts created pursuant to § 26.2654-1(b) at the discretion of the executor or trustee.

Under § 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute). Under § 301.9100-1(b), a regulatory election includes an election whose due date is prescribed by a notice published in the Internal Revenue Bulletin.

Notice 2001-50, 2001-2 C.B.189, provides that taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100-3.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer has acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Based on the facts submitted and the representations made, with respect to Ruling Requests 1, 2 and 3, we conclude that the requirements of § 301.9100-3 have been satisfied. Accordingly, extensions of time until the date that is 60 days after the date of this letter are granted:

1. To sever Trust B, effective as of Date 2, pursuant to section 26.2654-1(b), into Husband Exempt Marital Deduction Trust and Husband Non-exempt Marital Deduction Trust; and
2. To make a reverse QTIP election, effective as of Date 2, under section 2652(a)(3) with respect to the Husband Exempt Marital Deduction Trust; and
3. To allocate Husband's remaining GST exemption (that is, the amount remaining after the automatic allocation of \$N of GST exemption to Trust C) under § 2642(g) to the Husband Exempt Marital Deduction Trust.

The allocation, once made, will be effective as of Husband's date of death. In addition, the inclusion ratio of the Husband Exempt Marital Deduction Trust will be

determined based on the value of the trust property on the date of death of Husband, and the amount of GST exemption allocated to the trust.

A supplemental Form 706 should be filed with respect to Husband's estate containing a Schedule R on which, the severance of Trust B is reported, a reverse QTIP election is made with respect to the Husband Exempt Marital Deduction Trust, and on which Husband's remaining GST exemption is allocated with respect to that trust. The supplemental Form 706 should be filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to each return. Additional copies are enclosed for this purpose.

With respect to Ruling Requests 4 and 5, we conclude that the requirements of § 301.9100-3 have not been satisfied. Accordingly we are unable to grant the requested relief with respect to these rulings requests. Further, we conclude that those portions of the Date 5 Court order modifying Family Trust to direct payment of taxes and expenses from the non-exempt portions of the severed Trust B will not be given effect for federal transfer tax purposes. See, e.g., Estate of Nicholson v. Commissioner, 94 T.C. 666, 680 (1990).

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

William P. O'Shea
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)